INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	1
Statutes involved	2
Statement	2
Argument	5
Conclusion	9

CITATIONS

Cases:	
Bickford's, Inc. v. *Helvering*, 98 F. 2d 568	13
Fairbanks Court W. Groc. Co. v. *Commissioner*, 84 F. 2d 18, certiorari denied, 299 U. S. 582	13
Helvering v. *Minnesota Tea Co.*, 296 U. S. 378	11
LeTulle v. *Scofield*, 308 U. S. 415	11
Palm Springs Corp. v. *Commissioner*, 315 U. S. 185	13
Pinellas Ice Co. v. *Commissioner*, 287 U. S. 462	11
Statutes:	
Internal Revenue Code, Sec. 113 (U. S. C. Title 26, Sec. 113)	11
Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 112	3, 11
Revenue Act of 1932, c. 209, 47 Stat. 169:	
Sec. 112	2, 11
Sec. 113	3, 10
Revenue Act of 1934, c. 277, 48 Stat. 680:	
Sec. 113	4, 10
Sec. 114	4, 9
Revenue Act of 1936, c. 690, 49 Stat. 1648, Sec. 113 as amended	11
Revenue Act of 1938, c. 289, 52 Stat. 447:	
Sec. 113	11
Sec. 807	11
Miscellaneous:	
H. Rep. No. 1860, 75th Cong., 3d Sess., p. 32 (1939–1 Cum. Bull. (Part 2) 728, 751)	11

341121—43

In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 122

MUSKEGON MOTOR SPECIALTIES COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Board of Tax Appeals (R. 26–38) are reported at 45 B. T. A. 551. The opinion of the Circuit Court of Appeals (R. 208–215) is reported at 134 F. 2d 904.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 13, 1943 (R. 207). Petition for a writ of certiorari was filed June 28, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

The basic issue is whether the Commissioner correctly determined that the basis of the taxpayer's assets for depreciation is the same as the basis of those assets in the hands of its two predecessor companies. The issue turns upon the following questions:

1. Whether the taxpayer acquired the assets from the two predecessor companies in connection with a "reorganization," within the definition of Clause A of Section 112 (i) (1) of the Revenue Acts of 1928 and 1932.

2. Whether, immediately after such acquisition, "an interest or control in such property of 50 per centum or more remained in the same persons or any of them," as required by Section 113 (a) (7) of the Revenue Act of 1932.

STATUTES INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 112. RECOGNITION OF GAIN OR LOSS.
>
> * * * * * *
>
> (i) *Definition of Reorganization.* — As used in this section and sections 113 and 115—
>
> (1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of an-

other corporation, or substantially all the properties of another corporation), * * *.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(7) *Transfers to corporation where control of property remains in same persons.*—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

* * * * *

Section 112 (i) (1) of the Revenue Act of 1928, c. 852, 45 Stat. 791, is identical with Section 112 (i) (1) of the Revenue Act of 1932.

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that —

* * * * *

(12) *Basis established by Revenue Act of 1932.*—If the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1934, and the basis thereof, for the purposes of the Revenue Act of 1932 was prescribed by section 113 (a) (6), (7), or (9) of such Act, then for the purposes of this Act the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932.

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * *

STATEMENT

Muskegon Motor Specialties Company (herein referred to as Muskegon Michigan) and the L. O. Gordon Manufacturing Company (herein referred to as the Gordon Company) were Michigan corporations engaged in the business of manufacturing cam shafts. Muskegon Michigan had outstanding 4,500.9 shares of no par value capital stock and the Gordon Company had outstanding 2,000 shares of $100 par value capital stock. (R. 26–27.) Flanders Investment Company, a personal holding company for Fred L. Flanders, president of Muskegon Michigan, owned 2,228 shares of the Muskegon Michigan stock (R. 30, 31). L. O. Gordon, president of Gordon Company, and his wife owned 560 shares of the Gordon stock. None of the Muskegon Michigan stockholders owned any shares of Gordon Company, and none of the Gordon Company shareholders owned any shares of Muskegon Michigan. (R. 29, 30.)

Under date of November 7, 1928, a circular letter was sent to the stockholders of Muskegon Michigan setting out a plan for the consolidation or merger of the two companies, stating that it had been "unanimously agreed upon by the officers and directors of both companies, by all the stockholders of L. O. Gordon Manufacturing Company, and by 96 percent of the stockholders of this Company, and is now submitted to the remain-

ing stockholders of this company for their approval." The plan, as set forth in the letter, called for the organization of a new corporation and provided (R. 27):

> In exchange for the shares of no par value stock now held by the stockholders of this company, there will be issued to said stockholders shares of Class B stock of said new or consolidated corporation on the basis of 16⅔ shares of said Class B stock for each share of no par value stock now issued and outstanding and in addition to said stock there will be paid to the holders of the no par value stock of the present company in cash the sum of $171.30 per share.

The letter solicited the deposit of their stock in escrow for the purpose of carrying out the plan, and all of the shares were deposited (R. 27).

Gordon obtained options to purchase the 1,440 shares of Gordon Company stock not owned by himself or his wife, for cash at various prices ranging from $150 to $322.58 per share. All the shares of this company were likewise deposited in escrow. (R. 27.)

The taxpayer was incorporated in Delaware on November 24, 1928. It had an authorized capital of 62,500 shares of no par class A convertible preference stock and 187,500 shares of no par common stock. The class A stock carried a $2 per share per annum cumulative dividend. It was entitled upon liquidation to a preference in the

amount of all dividend arrearages and thereafter to a distribution per share equal to four times the amount distributed upon each share of common outstanding. The class A stock was callable on any dividend payment date, in whole or in part of $35 per share, together with all accrued and unpaid dividends. Each share of class A and each share of common stock entitled the holder to one vote for all purposes. (R. 27–28.)

On November 27, 1928, the taxpayer entered into a financing agreement with a group of bankers. The bankers agreed to buy all of the class A stock and 15,000 shares of the common stock for $1,385,000 in cash. The taxpayer agreed to issue 110,000 shares of its common stock and to pay $1,445,004.17 to the holders of all the capital stock of Muskegon Michigan and the Gordon Company. The difference of $60,004.17 between the amount to be received from the bankers and the amount to be paid to the old stockholders was to be recouped by means of a dividend to be paid to taxpayer by the Gordon Company. It was further agreed that the taxpayer might at any time after acquiring the stock of Muskegon Michigan and the Gordon Company acquire their assets upon surrender of the stock. It was contemplated that this would be done as soon as practicable. (R. 28–29.)

The agreement was closed on December 6, 1928, and the taxpayer issued to the bankers the 62,500 of its class A and 15,000 of its common stock for

$1,385,000. On the same day taxpayer acquired all of the shares of Gordon Company and Muskegon Michigan. In return for the 560 Gordon Company shares directly held by L. O. Gordon and his wife, the taxpayer paid $240,492.40 in cash or its equivalent and issued 35,000 shares of its new common stock. The remaining shares were acquired for $433,507.60 in cash, pursuant to the options which Gordon assigned to the taxpayer. In return for the Muskegon Michigan shares held by Flanders Investment Company, the taxpayer paid $381,652.23 in cash or its equivalent,[1] and issued 37,118⅓ shares of its new common stock. The remaining shares were acquired for $389,347.77 in cash and 37,881⅔ shares of new common. (R. 29–30.)

Upon the completion of these transactions, the taxpayer owned all the outstanding stock of Gordon Company and Muskegon Michigan. All of the taxpayer's authorized capital stock was issued and outstanding except for 62,500 shares of common reserved for conversion of the class A. (R.

[1] The taxpayer, on November 27, 1928, had formed two subsidiaries, Midland Investors, Inc., and Norton Securities Company, paying $225,000 for all the stock of Midland and $375,000 for all the stock of Norton. The market values of the shares of these subsidiaries on December 6, 1928, were $225,000 and $375,000, respectively. The payments to Mr. and Mrs. Gordon were in the form of $15,492.40 in cash plus all the shares of Midland. The payments to Flanders Investment Company were in the form of $6,652.23 in cash and all the shares of Norton. (R. 29–30.)

30.) Flanders, who had spoken for the stockholders of Muskegon Michigan, became chairman of the board and treasurer of the taxpayer. Gordon, who had represented the Gordon Company stockholders, became president. (R. 31–32.) Gordon Company and Muskegon Michigan were inactive after the taxpayer's acquisition of the stock, and were legally dissolved on January 23, 1929 (R. 31).

The aggregate cost to the taxpayer of the depreciable assets acquired in the transaction, measured by their market value at the time of acquisition, was $855,580.98. The adjusted basis of the assets in the hands of the two predecessor companies aggregated $238,045.14. (R. 32.)

The Board sustained the Commissioner's determination that the taxpayer must use the basis of the predecessor companies in computing depreciation (R. 33–38). The court below affirmed (R. 207–215).

ARGUMENT

Section 114 (a) of the Revenue Act of 1934, *supra,* provides that the basis for computing the depreciation allowance upon property "shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property." Section 113 (b) provides that the "adjusted basis for determining the gain or loss from the sale or other disposition of property * * * shall be the

basis determined under subsection (a)," with adjustments not here material. Section 113 (a) provides that "The basis of property shall be the cost of such property," with certain exceptions thereafter specified.

The Commissioner's position rested upon the exception to the basis of cost specified in Section 113 (a) (12). This section provides that if property was acquired prior to 1934—

> and the basis thereof, for the purposes of the Revenue Act of 1932 was prescribed by section 113 (a) (6), (7), or (9) of such Act, then for the purposes of this [the 1934] Act the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932.

Section 113 (a) (7) of the Revenue Act of 1932, *supra,* provides that if property was acquired—

> by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. * * *

The term "reorganization" is defined in Section 112 (i) (1) (A) of both the 1928 and the 1932 Acts, to mean, *inter alia*—

> a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation) * * *.

The taxpayer's contentions are twofold. First, the taxpayer argues that although the transaction comes within the literal definition of a reorganization contained in Clause A of Section 112 (i) (1), the stockholders of the predecessor companies did not retain the substantial interest in the transferred assets required for a reorganization under *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378; *Pinellas Ice Co.* v. *Commissioner*, 287 U. S. 462; and *LeTulle* v. *Scofield*, 308 U. S. 415. Secondly, the taxpayer argues that even if the property was acquired in connection with a reorganization, the bases of the transferor companies will not carry over because there was lacking the retention of the 50% interest or control required by Section 113 (a) (7).[2] We submit, however, that both

[2] The requirement is no longer present in the statutes with respect to reorganizations taking place in taxable years beginning after December 31, 1935. Revenue Act of 1936, Section 113 (a) (7), as amended by the Revenue Act of 1938, c. 289, 52 Stat. 447, Section 807; Revenue Act of 1938, Section 113 (a) (7); Internal Revenue Code, Section 113 (a)

points were correctly decided against the taxpayer, and that there is no occasion for further review.[3]

The first point involves the application of a familiar rule to the particular facts of the instant case. Stockholders of the old companies received all except 12% of the outstanding common stock of the new company. Muskegon Michigan stockholders received 60%; Gordon and his wife, 28%. The common was subject to the class A's annual dividend preference of $125,000, but as the court below pointed out (R. 212), the combined earnings of the two predecessor companies for the prior three years averaged over $240,000 annually. The common, moreover, had equal voting rights, share for share, with the class A, and hence voting control. The court below concluded that these common shares constituted a substantial stake in the taxpayer in view of the potential earnings attributable to them and the voice in the management which the shares represented. Contrary to the taxpayer's apparent contention (Br. 24), neither the added participation of the class A on liquidation nor the fact that the taxpayer's charter con-

---

(7); H. Rep. No. 1860, 75th Cong., 3d Sess., p. 32 (1939–1 Cum. Bull. (Part 2) 728, 751.)

[3] The taxpayer has not repeated in its supporting brief the argument, advanced in the court below and also rejected, that upon carry-over of the bases of the predecessor companies an adjustment should be made for the gain on the transaction realized by the individual stockholders. The lack of merit in the contention is clearly shown in the opinion below (R. 215).

tained the customary provision for a class vote on a sale, lease or exchange of all the assets, compels a different conclusion.

The taxpayer's argument on the second point is that although former stockholders of Muskegon Michigan and Gordon Company collectively owned more than 50% of the taxpayer's voting stock immediately after the transfer, the control requirement of Section 113 (a) (7) was not satisfied since Mr. and Mrs. Gordon, the stockholders of Gordon Company who continued to hold a stock interest in the enterprise, only owned 28% of the Gordon Company stock prior to the transfer.[4] As the court below pointed out, however (R. 213–214), the statute only requires that control remain "in the same persons or any of them." Even if we assume, therefore, that Mr. and Mrs. Gordon were not in control of Gordon Company before the transfer, plainly they are within the phrase "any of them."[5] See *Fairbanks Court W. Groc. Co.* v.

[4] The Board of Tax Appeals, it should be observed, had concluded that Gordon, by virtue of the options he had obtained, had become the owner of all the stock of Gordon Company (R. 37).

[5] The court did not pass on the question whether the former stockholders had retained a 50 percent "interest" as well as "control." It is sufficient, of course, if *either* is present. See *Palm Springs Corp.* v. *Commissioner*, 315 U. S. 185, 187–188, fn. 1; *Bickford's, Inc.* v. *Helvering*, 98 F. 2d 568, 569 (C. C. A. 2d). The *Bickford* case also points to the difference, noted by the court below, between the meaning of the term "control" in Section 113 (a) (7) and the meaning of that term as it is specifically defined for the purposes of Section 112 of the Act.

Commissioner, 84 F. 2d 18, 19–20 (C. C. A. 7th), certiorari denied, 299 U. S. 582. The suggestion that ownership of over 50% of the voting stock of the company did not represent "control" within the meaning of Section 113 (a) (7) in view of the class A's veto power on the sale, lease, or exchange of the assets seems plainly without merit.

There is no conflict.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted.

OSCAR COX,
Acting Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
SAMUEL H. LEVY,
JOSEPH M. JONES,
Special Assistants to the Attorney General.

JULY 1943.

U. S. GOVERNMENT PRINTING OFFICE: 1943